

UNITED STATES OF AMERICA  
POSTAL REGULATORY COMMISSION

Before Commissioners:

Ruth Y. Goldway, Chairman;  
Nanci E. Langley, Vice Chairman;  
Mark Acton; and  
Robert G. Taub

Consideration of Technical Methods to Be  
Applied in Workshare Discount Design

Docket No. RM2010-13

ORDER RESOLVING TECHNICAL ISSUES CONCERNING  
THE CALCULATION OF WORKSHARE DISCOUNTS



Washington, DC 20268-0001

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## I. EXECUTIVE SUMMARY

This Order evaluates and resolves several important issues related to interpretation of Postal Accountability and Enhancement Act (PAEA) of 2006 provisions affecting the proper pricing of workshare discounts.

Those provisions require that workshare discounts for "presorting, prebarcoding, handling, or transportation of mail, as further defined by the Postal Regulatory Commission" not exceed the cost the Postal Service avoids as a result of that activity. This docket was established to identify how best to implement that requirement.

Mailer organizations and the Postal Service have provided thoughtful and detailed comments. In addition, in response to requests from the Commission, the Postal Service has provided relevant data.

In this Order, the Commission determines that when calculating whether discounts exceed costs avoided by the Postal Service, costs avoided as a result of mailer activities integral to the worksharing, such as cleansing pre-barcoded addresses, may be recognized in workshare discounts.

The Commission also evaluates a number of proposed refinements to the analytical principles it applies when reviewing First-Class Mail workshare discounts, and accepts several changes recommended by participants. It agrees that shifting mailing patterns have made metered mail with information based indicia the category of First-Class Mail most likely to become workshared, *i.e.*, presorted or pre-barcoded. It also finds that when this type of mail becomes workshared, the Postal Service saves costs associated with mail collection.

The Commission notes with interest several mailers' proposals to develop rates based on a "bottom-up" costing system that might more accurately identify the cost differences between rate categories. It concludes, however, that Postal Service data collection systems are not sufficient at this time to accurately identify "bottom-up" costs.

## II. BACKGROUND

The Postal Accountability and Enhancement Act of 2006 (PAEA) revamped postal ratemaking. See 39 U.S.C. 3622. It directed the Postal Regulatory Commission to establish a new, modern regulatory system that would allow the Postal Service significant additional flexibility to price market dominant postal products subject to a limited number of statutory constraints. Constraints included (1) a cap on price increases [section 3622(d)], (2) limits on workshare discounts [section 3622(e)], and (3) formulae for establishing rates for preferred (largely nonprofit) categories of mail.

This proceeding explores how best to adhere to the statutory standards limiting workshare discounts. The PAEA recognized that the Postal Service already offered what were known as workshare discounts for certain mailer activities that reduced the cost of processing, transporting, or delivering mail. The limitations of section 3622(e) were made specifically applicable to “presorting, prebarcoding, handling, and transporting mail...as further defined by the Commission.” See 39 U.S.C. 3622(e)(a)(1). The concept of a workshare discount applies to categories of mail that have similar demand characteristics because they target the same market, but the categories cost the Postal Service different amounts to handle and deliver because of differing amounts of preparation that the mailer has elected to do.

Section 3622(e) establishes a cap on workshare discounts offered by the Postal Service that is equal to the cost that the Postal Service saves as a result of work performed by the mailer. This cap is subject to a set of exceptions where new worksharing programs are being introduced, where mail matter has particular educational or scientific value, where necessary to avoid rate shock, where the efficient operation of the Postal Service requires it, or where otherwise the contribution to overhead from the discounted category would be reduced.<sup>1</sup>

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<sup>1</sup> See 39 U.S.C. 3622(e)(2) and (3).

The cap on workshare discounts and the exceptions to the cap essentially codify the approach that the former Postal Rate Commission had developed for evaluating the appropriateness of discounts prior to the adoption of the PAEA. The Commission's approach was to apply the logic of the Efficient Component Pricing (ECP) rule when setting discounts, unless there was an overriding consideration.<sup>2</sup>

The ECP rule asserts that an integrated mail service will be produced most efficiently if its various components are provided by the least-cost producer. A mailer will be the least-cost producer of a workshared component if the cost to the mailer of producing that component is less than the amount that the component saves the Postal Service. Therefore, the discount given to the mailer for worksharing its mail should be no greater than the amount that the worksharing saves the Postal Service. Following this rule, the mailer and the Postal Service will each provide only those components of an integrated service that they can produce at the lowest cost. This will minimize the overall cost of the integrated service.<sup>3</sup>

Subsection 3622(e)(2) provides that the Commission shall ensure "that discounts do not exceed the cost that the Postal Service avoids" when mailers workshare. To implement that standard, it is necessary to identify a baseline, or reference category of mail from which avoided costs can be measured. A baseline category of mail should include mail that serves the same market, and is likely to be workshared if a sufficient

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<sup>2</sup> Under the logic of ECP, productive efficiency is maximized when a discount is set equal to the costs that worksharing by the mailer saves the Postal Service. This avoids over-incentivising or under-incentivising the mailer to undertake the worksharing activity. The most notable departure in section 3622(e) from the approach taken by the former Postal Rate Commission is that it places only a cap on the size of the discount. Under section 3622(e), the Postal Service may offer as small a discount for worksharing as it sees fit.

<sup>3</sup> See, e.g., Docket No. MC95-1 at ¶¶ 4253, 4291; Docket No. R2006-1 at 81-91. For discounts that follow the ECP rule, there is no need for the Postal Service to speculate about the mailer's cost of producing a component of an integrated service. If the Postal Service sets a discount equal to its own cost of producing a component, the mailer will be responsible for comparing the discount to his production cost. The mailer will produce the component if his production cost is less than the discount.

incentive to workshare is made available.<sup>4</sup> The identification of appropriate baseline categories has been the subject of substantial analysis over the years. Prior to enactment of the PAEA, the Commission recommended workshare discounts that recognized that there was a worksharing relationship between a substantial portion of single-piece and presorted First-Class Mail.

Since Docket No. R97-1, Bulk Metered Mail (BMM) has been used as the baseline for setting discounts for presorted First-Class letters. BMM consists of machinable, homogenous, non-barcoded pieces with machine-printed addresses, properly faced, and entered at Postal Service facilities in full trays. See PRC Op. R97-1, ¶¶ 292-94.

In Docket No. R2009-2, the Postal Service argued that the PAEA section 3622(e) cap on workshare discounts applies only to price categories within individual “products,” rather than across products.<sup>5</sup> Single-piece First-Class Mail and presorted First-Class Mail are classified as separate market dominant products. Therefore, if section 3622(e) were interpreted as the Postal Service proposed, it would not constrain the price relationship between BMM, which is a subset of single-piece First-Class Mail, and workshared First-Class Mail, but only the price relationship among tiers of presort First-Class Mail.

Because the proper interpretation of the section 3622(e) cap on workshare discounts has important public policy implications, the Commission deferred ruling on it in Docket No. R2009-2 and deferred placing constraints on the Postal Service’s setting

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<sup>4</sup> From the mailers’ viewpoint, different categories of mail serve the same market if they accomplish their business-communication purpose equally well. The mailer’s decision to select one mail category over another then turns only on differences in cost to the mailer. A rational mailer will have an incentive to workshare if the price difference offered for worksharing is as great, or greater, than the cost to it of converting non-workshared to workshared mail. See PRC Op. R2006-1, at 90-91, citing Tr. 26/9164, 9259-60 (Panzar).

<sup>5</sup> See Docket No R2009-2, Response of the United States Postal Service to Chairman’s Information Request No. 1, February 20, 2009.

of discounts for workshared mail until after the issue could be addressed and resolved in a docket established specifically for that purpose. *Id.* at 6.

Docket No. RM2009-3 was established on March 16, 2009, to resolve the legal issue of what kind of price relationships are regulated by section 3622(e) generally, and whether the specific relationships between single-piece and presort First-Class Mail, and between Standard High Density and Standard Saturation mail, are subject to section 3622(e). Docket No. RM2009-3 culminated in Order No. 536. In that Order, the Commission analyzed the language of 3622(e) and the purpose underlying its cap on the size of workshare discounts. It concluded that the purpose of that cap is to prevent discounts that incent mailers to do work that costs the mailer more than it would cost the Postal Service. As explained above, the ECP rule asserts that constraining workshare discounts to equal the amount that worksharing saves the Postal Service minimizes the cost to society of providing that service.<sup>6</sup>

Order No. 536 concluded that whether the cap on workshare discounts applies to a particular pair of services is not determined by whether the two services have been labeled separate “products” for other purposes, but on a factual assessment of whether they serve the same market in essentially the same way and mailers choose between them primarily on the basis of price. *Id.* at 19-32. Order No. 536 applied these factual criteria to Standard High Density and Standard Saturation Mail and concluded that they served different market needs. Therefore, they were not in a worksharing relationship for purposes of applying the section 3622(e) cap on discounts. *Id.* at 59-61. Applying these factual criteria to First-Class Mail, the Commission concluded that a substantial

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<sup>6</sup> Docket No. RM2009-3, Order Adopting Analytical Principles Regarding Workshare Discount Methodologies, September 14, 2010, at 37-38, 41-44, 48-49 (Order No. 536). See PRC Op. MC95-1 at IV, 115-123. While section 3622(e) embodies the logic of the ECP rule, it implements only half of the constraint that the logic of the rule requires. To fully implement the ECP rule, section 3622(e) would have had to impose a floor as well as a ceiling on workshare discounts so that they are no more, and no less, than the cost that worksharing saves the Postal Service. However, section 3622(e) does not impose a floor on discounts. Instead, it allows the Postal Service substantial pricing flexibility to offer discounts in the amounts it chooses, so long as it does not incent mailers to do work Postal Service employees could do less expensively.

portion of single-piece mail targets the same market in essentially the same way that presort First-Class Mail does, and therefore, single-piece and presort First-Class Mail are in a worksharing relationship that is subject to the section 3622(e) cap. *Id.* at 49-59.<sup>7</sup>

Order No. 536 also addressed the legal issue of what mailer-supplied refinements to mail should be recognized in “workshare discounts” under section 3622(e)(1). That provision defines worksharing as the “presorting, prebarcoding, handling, or transportation of mail, as further defined by the Postal Regulatory Commission under subsection (a).”<sup>8</sup> In Order No. 536, the Commission observed that achieving the savings that a workshare characteristic named in section 3622(e)(1) is intended to achieve often requires the presence of other ancillary characteristics supplied by the mailer. When this is the case, the Commission measures the cost avoided by worksharing in the context in which the workshared mail is presented to the Postal Service. Otherwise, the cost avoidance calculation would not provide a sound basis for applying the ECP rule, and would not serve the purpose that underlies the cap on workshare discounts. *Id.* at 46-47. The Commission published provisional guidelines in Order No. 536 that were meant to allow the cost effect of mailer-supplied ancillary characteristics to be reflected in avoidable cost calculations.

The instant docket is a follow-on proceeding to Docket No. RM2009-3. Its parameters were established in Order No. 537.<sup>9</sup> That Order solicits comments on the appropriate benchmark for measuring First-Class Mail workshare discounts, including the specific cost characteristics that the benchmark selected should have. It allows participants to submit technical proposals to revise or refine the manner in which

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<sup>7</sup> This determination, among others, was appealed in *United States Postal Service v. Postal Regulatory Commission*, (D.C. Cir. No. 10-1324), and dismissed as not ripe, October 21, 2011.

<sup>8</sup> The reference is to subsection 3622(a), the Commission’s general authority to promulgate regulations necessary to establish a modern system of rate regulation.

<sup>9</sup> Docket No. RM2010-3, Notice of Proposed Rulemaking Concerning the Technical Methods to be Applied in Designing Workshare Discounts, September 14, 2010 (Order No. 537).



avoided costs are modeled. It also allows participants to propose additional discounted rate categories for First-Class workshared mail.

In addition to those of the Postal Service, 15 sets of initial comments were filed in this docket.<sup>10</sup> All but one are confined to issues raised by First-Class Mail. See PostCom Comments. Seven sets of reply comments were received. Five address issues raised by First-Class Mail.<sup>11</sup> Two address issues raised by Standard Mail.<sup>12</sup>

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<sup>10</sup> See Initial Comments of American Postal Workers Union, AFL-CIO, February 18, 2011 (APWU Comments); Joint Comments of American Bankers Association, the Bank of America Corporation, the Direct Mail Association, Discover Financial Services, the Major Mailers Association, the National Association of Presort Mailers, and the National Postal Policy Council, February 18, 2011 (ABA, et al. Comments); Initial Comments of the Association for Postal Commerce, February 18, 2011 (PostCom Comments); Initial Comments of the Greeting Card Association, February 18, 2011 (GCA Comments); Comments of Florida Mail and Print Solutions Inc. on Consideration of Technical Methods to Be Applied in Workshare Discount Design, February 18, 2011 (Florida Mail and Print Solutions Comments); Comments of Immediate Mailing Services, Inc. on Consideration of Technical Methods to Be Applied in Workshare Discount Design, February 18, 2011 (Immediate Mailings Services Comments); Comments of L&M Mail Service on Consideration of Technical Methods to Be Applied in Workshare Discount Design, February 18, 2011 (L&M Service Comments); Comments of Neopost USA, February 18, 2011 (Neopost Comments); Comments of On-Line Data on Consideration of Technical Methods to Be Applied in Workshare Discount Design, February 18, 2011 (On-Line Data Comments); Comments of Pitney Bowes Inc., February 18, 2011 (Pitney Bowes Comments); Comments of Presort Services, Inc. on Consideration of Technical Methods to Be Applied in Workshare Discount Design, February 18, 2011 (Presort Services Comments); Comments of the Public Representative in Response to Order No. 537, February 18, 2011 (PR Comments); Initial Comments of Stamps.com, February 18, 2011 (Stamps.com Comments); Comments of TC Delivers on Consideration of Technical Methods to Be Applied in Workshare Discount Design, February 18, 2011 (TC Delivers Comments); Comments of United Mailing Services, Inc., February 18, 2011 (United Mailing Services Comments); Initial Comments of the United States Postal Service, February 18, 2011 (Postal Service Comments).

<sup>11</sup> Reply Comments of the American Bankers Association, the Bank of America Corporation, the Direct Mail Association, Discover Financial Services, the Major Mailers Association, the National Association of Presort Mailers, and the National Postal Policy Council, April 4, 2011 (ABA et al. Reply Comments); Amended Reply Comments of the Greeting Card Association, April 12, 2011 (GCA Reply Comments); Reply Comments of the Public Representative, April 4, 2011 (PR Reply Comments); Reply Comments of Pitney Bowes, Inc., April 4, 2011 (Pitney Bowes Reply Comments); Reply Comments of the United States Postal Service, April 4, 2011 (Postal Service Reply Comments).

<sup>12</sup> Reply Comments of the Association for Postal Commerce, April 4, 2011 (PostCom Reply Comments); Valpak Direct Marketing System, Inc. and Valpak Dealers' Association, Inc., Reply Comments, April 4, 2011 (Valpak Reply Comments).

### III. BENCHMARK ISSUES

In Order No. 536, the Commission recognized that BMM may no longer be the best Base Group for estimating the worksharing savings for First-Class letters. Order No. 536 at 63. The Commission noted that the assumption that a significant amount of single-piece mail is entered faced in full trays at Postal Service facilities needed to be re-examined. *Id.*

*Proposed Base Groups.* In this docket, the Commission sought comments on the appropriate Base Group or benchmark for measuring First-Class Mail workshare discounts. Several parties propose criteria for identifying the most appropriate benchmark. Generally, commenters suggest that the Base Group should be (1) theoretically correct, (2) empirically based, and (3) measurable and verifiable, with cost characteristics that are readily traceable to the Postal Service's existing cost systems. Postal Service Comments at 8-9; GCA Comments at 7-8; Pitney Bowes Comments at 4; ABA et al. Comments at 7.

The proposed benchmarks can be grouped into the following four categories: BMM, metered mail, single-piece First-Class Mail, and Information Based Indicia (IBI) mail. Each benchmark or Base Group is described below.

*BMM.* The American Workers Postal Union (APWU) suggests that the Commission retain the current BMM Base Group. APWU argues that the BMM letter Base Group ensures compliance with the statutory policy articulated in sections 101(a)-(b) and 404(c) of the PAEA which requires that there will be an expedited letter mail service that is universally available at uniform rates. APWU Comments at 2-4. In addition, APWU argues that only the BMM Base Group guarantees that discounts will not exceed the costs avoided by worksharing activity. *Id.* at 4-7. APWU asserts that changing the Base Group would increase the cost of postage for the mailing public. *Id.* at 8.

*Metered mail.* Nine commenters propose that the Commission adopt metered mail as the Base Group to represent mail likely to convert to presort.<sup>13</sup> As indicated in the Postal Service's response to CHIR No. 1,<sup>14</sup> metered mail is a broad category that includes metered, IBI, and Postage Validation Imprint (PVI) letters.<sup>15</sup> Comments from the presort bureaus indicate that the type of First-Class Mail they handle has the characteristics of metered letters.<sup>16</sup> In addition, ABA et al. present data from three surveys of presort bureaus designed to gather empirical data on an appropriate Base Group. ABA et al. Comments at 8-10. Based on the survey results, ABA et al. assert that metered mail is the group most representative of First-Class letters likely to convert to presort. *Id.* at 19-21.

*Single-piece First-Class Mail.* United Mailing Services, Inc. appears<sup>17</sup> to advocate that the Commission adopt single-piece First-Class Mail as the benchmark representing First-Class letters likely to convert to presort. United Mail Services suggests that the "benchmark being used to establish workshare discounts should be full-rate First Class Mail prices...." *Id.* at 2. It further suggests that full-rate First-Class Mail is the type of mail it converts into workshare discount mail. *Id.* at 8.

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<sup>13</sup> Metered mail advocates include (1) Florida Mail and Print Solutions Inc.; (2) Joint Comments of the American Bankers Association, The Bank of America Corporation, The Direct Market Association, Discover Financial Services, The Major Mailers Association; The National Association of Presort Mailers, and the National Postal Policy Council; (3) Immediate Mail Services; (4) L&M Mail Service; (5) TC Delivers; (6) On-Line Data; (7) Pitney Bowes, Inc.; (8) Postal Service; and (9) Presort Services, Inc.

<sup>14</sup> Response of the United States Postal Service to Chairman's Information Request No. 1, January 18, 2011 (Postal Service Response to CHIR No. 1).

<sup>15</sup> The Postal Service clarified the definition of metered mail in response to CHIR No. 1.

<sup>16</sup> Florida Mail and Print Solutions Inc. at 3; Immediate Mail Services at 3; L&M Mail Service at 5; TC Delivers at 3; On-Line Data at 3; Presort Services, Inc. at 3.

<sup>17</sup> The Commission assumes that United Mailing Services, Inc.'s use of the phrase "full-rate First Class Mail prices" refers to single-piece First-Class letters. However, consistent with other presort bureaus that submitted comments, United Mailing Services, Inc. may have intended to argue that metered First-Class letters should serve as the benchmark. In its comments, UMS states that eight of its last 10 new customers "were metering at FCM Full rate." United Mailing Services Comments at 8.

*IBI mail.* The Public Representative and GCA propose that the Commission select IBI letters as the Base Group for presorted First-Class letters. Both parties assert that using IBI letters is reasonable because IBI letter volume is approximately 90 percent of the broad metered mail category.<sup>18</sup> GCA suggests that the large volume of IBI mail and its continued growth as a percentage of all single-piece mail make it a good candidate. GCA Comments at 13.

*Commission analysis.* The Commission does not accept APWU's argument that BMM is the only Base Group that ensures compliance with the PAEA. As ABA et al. indicate, the policy provisions of sections 101(a) and 101(b) are not directly impacted by the selection of an appropriate benchmark. ABA et al. Reply Comments at 4-5. In addition, the selection of a benchmark does not implicate section 404(c)'s requirement that the Postal Service maintain a class of mail with a rate that is uniform throughout the United States.

In terms of cost characteristics, BMM is the most refined of the proposed benchmarks, and therefore is likely to lead to the smallest avoided cost estimate, the smallest discount, and therefore the lowest rate for single-piece First-Class Mail. Anecdotal evidence filed in the comments of the presort bureaus,<sup>19</sup> as well as the studies commissioned by Pitney Bowes and ABA et al., however, show that the letters most likely to convert to presort do not share all of the characteristics of BMM. They are not trayed and faced, nor are they entered in bulk at Postal Service facilities.<sup>20</sup> Pitney Bowes's study shows that only approximately 20 percent of undiscounted non-household mail is entered as BMM. Pitney Bowes Comments at 3; ABA et al. Comments at 15. ABA et al. indicate that less than 4 percent of the surveyed National

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<sup>18</sup> Response to CHIR No. 1 at 4; see *also* PR Comments at 2; GCA Comments at 13.

<sup>19</sup> Florida Mail and Print Solutions Inc. Comments at 3; Immediate Mail Services Comments at 3; L&M Mail Service Comments at 5; TC Delivers Comments at 3; On-Line Data Comments at 3; Presort Services, Inc. Comments at 3.

<sup>20</sup> ABA et al. present three empirical studies discussed in the collection costs section. See section II(C)(3), *infra*.

Association of Presort Mailers (NAPM) members who currently use single-piece First-Class Mail enter their mail as BMM. ABA et al. Comments at 11.

Consistent with the majority of the participants, the Commission finds that the broad metered mail category that includes metered, IBI, and PVI letters best satisfies the Base Group selection criteria advocated by the large majority of participants. Although BMM may have made up a substantial portion of single-piece First-Class Mail when it was originally selected as the worksharing Base Group in Docket No. R97-1, that is no longer the case. This record indicates that BMM now makes up only a small portion of the single-piece First-Class Mail that is likely to convert to presort First-Class Mail. It indicates that most converted mail now comes from a more diverse group of mail with the broader set of cost characteristics exhibited by metered mail. Because it is more representative of mail that converts to presort First-Class Mail, a metered mail Base Group is preferable to a BMM Base Group from a theoretical standpoint.<sup>21</sup> Metered mail also provides an empirically-based benchmark, since its costs can be developed with data that are collected in standard postal data systems. The cost characteristics of metered mail are measurable, verifiable, and, for the most part, readily traceable to the Postal Service's existing cost systems. For all of these reasons, the Commission adopts metered mail as the Base Group for calculating the costs avoided by presort First-Class Mail.<sup>22</sup>

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<sup>21</sup> Postal Service Comments at 8-9; GCA Comments at 7-8; Pitney Bowes Comments at 4; ABA et al. Comments at 7.

<sup>22</sup> The convention of setting the rate for the metered mail Base Group equal to the single-piece letter rate is not an issue that was explored on this record. However, there does not appear to be any obvious legal barrier to the Postal Service exercising its pricing flexibility by setting the rate for the metered mail Base Group at a different level than the remainder of single-piece First-Class letters. Moreover, the relative sophistication of users of the metered mail Base Group and the capabilities of metered and IBI technology suggest that a non-integer rate for this type of mail would be more workable than for other types of single-piece First-Class Mail.

## IV. IDENTIFICATION OF AVOIDED COSTS UNDER SECTION 3622(e)

Section 3622(e)(2) obligates the Commission to ensure that discounts “do not exceed the costs that the Postal Service avoids as a result of workshare activity.” This task is more complex than would appear at first blush. The Commission observed that there are mailer-supplied ancillary characteristics that are not specifically enumerated in subsection 3622(e)(1), but that must be supplied in conjunction with named worksharing characteristics to achieve the savings for which the workshare discount is designed. The Commission also observed that the value of the named workshare characteristic (such as pre-barcoding) often cannot be measured apart from the effect of the integral but unnamed ancillary characteristic (such as address hygiene activities) supplied by the mailer. Order No. 536 at 41-44.

In Docket No. RM2009-3, some mailers argued that section 3622(e) does not allow the effect that such ancillary characteristics might have on the amount that workshare activities save the Postal Service to be included in the cost avoidance calculation. The Commission disagreed. It concluded that the effect of an ancillary characteristic on the costs that the workshare activity saves the Postal Service should be included in the cost avoidance calculation.

As the Commission noted, this follows from the purpose underlying the limit on the size of the discount by section 3622(e). In Docket No. RM2009-3, the Commission observed

The Efficient Component Pricing (ECP) rule holds that if a workshare discount exceeds the cost avoided by worksharing, it will encourage a less efficient producer (the private mailer) to do the work. There is a consensus among the commenters that the Congressional purpose in limiting workshare discounts at the level of avoided costs is to have workshare discounts comply with this element of the ECP rule.

*Id.* at 37.

In order to properly assure that discounts are no greater than the cost that worksharing saves the Postal Service, it is necessary to identify the cost that the Postal Service actually saves.

The Postal Service conceded this point with respect to address cleansing and pre-barcoding. It noted that if mailers pre-barcode mail without first ensuring that the coded addresses are correct, the Postal Service's savings are not comparable to the savings it would capture if it barcoded the mail itself. If pre-barcoding by the mailer does not have the added element of address cleansing, the Postal Service observed, "there is no point in setting discounts exactly equal to avoided costs." Docket No. RM2009-3, Response of the United States Postal Service to Notice of Inquiry No. 1, September 11, 2009, at 10 (Postal Service Response to NOI No. 1).

The Postal Service, however, disagreed that the costs avoided by presorting should reflect the effect of density, even though the value of presorting depends on the density of the addresses of the presorted mail.<sup>23</sup> By arguing that some mail characteristics that are ancillary to the workshare activities listed in section 3622(e) should be reflected in avoided costs, and others should not, the Postal Service created considerable uncertainty as to what avoided costs should be reflected in discounts under section 3622(e).

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<sup>23</sup> Order No. 536 at 43 noted that presorting mail by ZIP Code would be of no value if the density of the mailing were to fall below a certain level. For example, presorting a mailing by order of address would not save the Postal Service any money if the mailing consisted of only five pieces. It would not be practical or useful to try to preserve the sort order of a five-piece mailing in a bundle, tray, or sack as the mailing makes its way through the system.

Under these circumstances, the Commission perceived a need to provide consistent criteria for determining whether the discount for a workshare characteristic named in subsection 3622(e)(1) (such as pre-barcoding or presorting) should reflect the cost effect of other ancillary characteristics on which the effectiveness of the named workshare characteristics depends (such as address hygiene or density, respectively). Therefore, the Commission concluded that, with respect to the four workshare characteristics named in subsection 3622(e)(1), the avoided cost calculation should reflect the cost impact of ancillary characteristics that

- Materially affect the value to the Postal Service of the named worksharing activity;
- Are practical for the mailer to alter in response to the discount for the named worksharing activity; and
- Whose cost impact cannot feasibly be isolated from the impact of the named worksharing activity, and therefore cannot provide a basis for a separate discount.

It deferred to the instant docket the opportunity for public comment on the suitability of those guidelines as applied to particular discounts, and how those guidelines might be refined. Order No. 536 at 45-46.

In the instant docket, GCA criticizes those guidelines. It argues that they expand the cap on discounts to areas where the logic of ECP does not apply. GCA Comments at 19-20. GCA asserts that the logic of ECP “assumes that the mailer activity to which the discount attaches displaces a corresponding activity performed by the Postal Service.” *Id.* at 20. It asserts that if an activity “is not one the Service would perform, the Service would expend no resources on it and it would have no [cost].” GCA argues that without a Postal Service cost to calculate, “there is nothing with which to compare the mailer’s cost to perform the activity, and therefore no basis for setting a discount.” *Id.* at 21.



Pitney Bowes replies that this issue was addressed by the testimony of witness John Panzar, the economist most directly responsible for formulating the ECP rule, in Docket No. R2006-1. The relevant inquiry, according to witness Panzar, is whether the mailer-supplied refinement reduces the Postal Service's costs, not whether it is a refinement that mirrors a Postal Service activity. As long as the reward for the cost-saving refinement equals the costs that the refinement saves the Postal Service, the logic of the ECP rule remains operative. Pitney Bowes Reply Brief at 20-21, citing Docket No. R2006-1, PB-T-1(Panzar) at 7.

The Commission agrees with Pitney Bowes and witness Panzar that a mailer activity need not mirror and displace an analogous activity that the Postal Service would otherwise perform for the logic of ECP to apply. Nor is there anything in the relevant language of section 3662(e) that requires a perfect correspondence between what a mailer might do to its mailing to make it less expensive for the Postal Service to process, and what the Postal Service itself would have done. Subsection 3622(e)(1) says that the term "workshare discount" refers to discounts provided to mailers for "presorting, prebarcoding, handling, or transportation of mail." Subsection 3622(e)(2) says that the Commission shall ensure that workshare discounts "do not exceed **the cost** that the Postal Service avoids as a result of workshare activity." (Emphasis supplied.) Neither subsection restricts the work that is shared to analogous work.

The flaw in GCA's reasoning is apparent when one applies it to a specific circumstance. Most mailers sort a mailing list electronically before they produce a mailing from that list and submit it to the Postal Service. Such sorting is highly efficient and very inexpensive. If the Postal Service were to receive a hard-copy mailing going to the same addresses, it would not be in a position to sort it electronically. All it could do would be to physically sort the mail on automated sorting equipment. This fact is no reason to prevent the Postal Service from offering a presortation discount for mail that a mailer has presorted electronically. The amount that an electronically presorted mailing saves the Postal Service compared to an equivalent mailing of unsorted hard-copy mail

can be measured. It then can be translated into a discount in the amount that will promote productive efficiency in the mailer's decision making. The cost to the Postal Service of electronically presorting mail from a list cannot be measured because it is an action that the Postal Service cannot undertake. This fact, however, is irrelevant to the effectiveness of ECP, and irrelevant to the scope of the worksharing that is subject to section 3622(e).

GCA concludes that

the Commission has significantly expanded "worksharing" beyond the area in which the Efficient Component Pricing Rule (ECPR) can both imply that discounts are appropriate in the circumstances and dictate their proper level.

GCA goes on to conclude that

adoption in Docket No. RM2009-3 of a broadened definition of worksharing raises important additional questions which will have to be answered in the course of constructing discounts under the new rule.

GCA Comments at 19.

GCA's misreads Order No. 536. Order No. 536 proposes guidelines for determining how to measure costs avoided when a mailer subjects his mail to any of the four workshare activities enumerated in subsection 3622(e)(1). Those guidelines are not intended to expand or contract the definition of workshare activities provided by section 3622(e). They are meant to provide guidance in measuring the full cost savings to the Postal Service that are achieved when it receives mail refined by one of the four workshare activities identified in section 3622(e). Cost savings calculations for these activities should reflect workshare mail as it is actually received by the Postal Service.

As noted earlier, the Postal Service sometimes requires a mailer to make additional refinements to his mailing in order to qualify for a discount for one of the four workshare activities named in subsection 3622(e)(1). For example, one of the four

activities named in subsection 3622(e)(1) is pre-barcoding. To qualify for a pre-barcoding discount, the Postal Service requires a mailer to screen its barcodes to ensure that they are accurate and up to date. The costs that pre-barcoding saves the Postal Service depend heavily on whether the barcodes have been prescreened for accuracy. The Postal Service agrees that the impact of prescreening barcodes for accuracy must be taken into account when the savings brought about by pre-barcoding are estimated. If it is not, the costs estimated are not the costs that pre-barcoding actually saves. If the costs estimated are not the costs actually saved by pre-barcoding, the Postal Service agrees that the estimate is not meaningful for purposes of establishing discounts because it does not indicate what an economically efficient discount for pre-barcoding would be. Postal Service Response to NOI No. 1 at 10.

The guidelines proposed in Order No. 536 are intended to generalize the reasoning that both the Postal Service and the Commission agree should be applied to the circumstance where the mailer decides whether to seek a discount for pre-barcoding. They are needed because there are other circumstances where the value to the Postal Service of a workshare activity named in subsection 3622(e)(1) depends heavily on the presence of a qualifying ancillary characteristic that also is required by the Postal Service to be eligible for that discount.

The guidelines are meant to help the Postal Service and mailers anticipate when the effect of other required refinements on the value of the workshare activity listed in subsection 3622(e)(1) should be reflected in the estimate of the costs that the listed workshare activity avoids. The guidelines proposed in Order No. 536 and adopted in the instant Order, therefore, are guidelines for accurately measuring the savings brought about by one of the worksharing activities named in subsection 3622(e)(1). They do not provide a basis for applying subsection 3622(e)(1) to independent discounts for mailer-supplied refinements that are not workshare activities named in that subsection, nor do they change the definition of the activities named in that subsection.

For these reasons, GCA's criticism that the guidelines change the definition of workshare activities in the statute is invalid.

GCA's criticism is the only criticism offered in the instant docket of the Commission's guidelines. Since the Commission does not find that criticism persuasive, the guidelines that the Commission formulated in Docket No. RM2009-3 remain valid tests for determining which mailer-supplied activities should be recognized in the cost avoidance calculations upon which workshare discounts are based. Going forward, workshare discounts may be as large as costs the Postal Service avoids as a result of workshare activities, including the value of ancillary activities performed as an essential part of those specified workshare activities.

## V. CALCULATING COSTS AVOIDED BY WORKSHARING

Current workshare discounts for First-Class Mail letters reflect avoidable mail processing and delivery costs. However, in Docket No. RM2009-3, several parties suggested that collection costs should also be considered avoidable because mail that is targeted by presort firms is mail that would otherwise be collected by the Postal Service. In Order No. 536, the Commission concluded that collection costs could reasonably fall within the term “handling” in section 3622(e)(1). Order No. 536 at 63 n.46. The instant docket provided parties with an opportunity to discuss whether collection costs should be included as a cost characteristic of the Base Group. No participant took issue with that aspect of Order No. 536 in this docket.

Order No. 537 sought comments on the specific cost characteristics that the Base Group should exhibit under section 3622(e). Order No. 537 at 2. In response to CHIR No. 1, the Postal Service provided estimates of mail processing, delivery, and collection costs that potential benchmarks would avoid. As the Commission has determined metered mail to be the most appropriate benchmark, this section focuses on the comments received regarding the cost characteristics of metered mail. Some parties suggest that due to concerns about the quality of the metered mail cost data provided by the Postal Service, proxies might be more appropriate for certain elements of those costs. Below, the Commission discusses comments on the three potential sources of cost that a metered mail Base Group would avoid: mail processing, delivery, and collection costs.

### A. Mail Processing

*Background.* Since Docket No. R2006-1, the Commission has used the mail processing costs for all metered letters as a proxy for the mail processing costs of the BMM benchmark.

*Parties' positions.* Both the Postal Service and ABA et al. propose that the mail processing costs for the metered mail Base Group should be the broad "metered" category which includes metered, IBI, and PVI letters. Postal Service Comments at 9; ABA et al. Comments at 20. No other participants address avoided mail processing costs.

*Commission analysis.* The Commission agrees with the Postal Service and ABA et al. that the mail processing costs for the broad metered category should be adopted for the metered mail Base Group. As a practical matter, adoption of metered mail as the Base Group does not alter the estimate of the mail processing costs that are avoided by First-Class Mail workshared letters.

#### B. Delivery

Since Docket No. R2006-1, the Commission has used the delivery costs of nonautomation machinable pieces sorted to mixed automated area distribution center (NAMMA), letters to represent the delivery costs of the BMM benchmark. The cost of delivering NAMMA letters is similar to that of BMM because both are properly faced and entered in trays, but neither is barcoded or presorted. Additionally, the established mail flow model estimates that the Delivery Point Sequence (DPS) percentage for BMM and NAMMA letters is the same. The same considerations indicate that NAMMA delivery costs provide the most reasonable available proxy for the delivery costs that would be avoided by converting metered First-Class Mail letters to presort. See PRC Op. R2006-1, ¶ 5158.

*Parties' positions.* The Postal Service, GCA, and ABA et al. offered insight on delivery cost characteristics for the Base Group.

Both the Postal Service and ABA et al. argue that the metered mail delivery costs provided in response to CHIR No. 1 should be used to estimate the delivery costs that would be avoided if metered mail were workshared.<sup>24</sup> According to the Postal Service, mail that is likely to convert to presort is no longer mail that is faced and trayed. Thus, the Postal Service proposes that the Commission use the metered mail delivery cost estimate it provides in response to CHIR No. 1, rather than the NAMMA proxy, for the broad metered mail baseline category. The Postal Service's response to CHIR No. 1 shows that its metered mail delivery cost figure (9.586 cents) is an aggregation of delivery and collection costs.<sup>25</sup> However, the Postal Service asserts that the mail that is likely to convert does not incur collection costs. Postal Service Comments at 9. The Postal Service provides a separate estimate for single-piece metered collection costs (3.811 cents) and proposes to remove them from its delivery cost estimate. *Id.* This would result in a metered mail delivery cost figure of 5.775 cents.

GCA contends that the current NAMMA proxy should be used to represent the delivery costs that would be avoided by the metered mail Base Group because the accuracy of the Postal Service's metered mail delivery cost estimate is suspect. GCA Reply Comments at 28-33. GCA observes that the FY 2010 unit delivery cost of stamped single-piece letters is lower than that calculated for metered letters. *Id.* at 32. According to GCA, this indicates that the estimate of avoidable delivery costs for metered mail is not valid, since one would expect single-piece letters to have a higher in-office delivery cost than metered letters.

GCA asserts that the Postal Service could have measured the in-office delivery cost associated with metered letters despite the fact that BMM was the Base Group.

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<sup>24</sup> Postal Service Comments at 9; ABA et al. Comments at 20. ABA et al. indicate that street delivery costs should not be part of the Base Group costs because converting a piece from single-piece to presort should not have an effect on its address or any characteristics that are likely to affect delivery costs once the mailpiece gets to the street. *Id.* at 20 n.25.

<sup>25</sup> Postal Service Response to CHIR No. 1, Excel file "ChIR.No.1.Delvry.Indicia.Collctn.xls," worksheet 'Delivery.'

*Id.* at 32 n.47. It asserts that delivery costs for metered mail were not estimated because the in-office delivery costs are the same for BMM and metered letters. According to GCA, this implies that NAMMA delivery costs are an appropriate proxy for both BMM and metered letter delivery costs. *Id.*

*Commission analysis.* The Commission finds the comparison of NAMMA to presort First-Class Mail letters provides the best available means of isolating the delivery costs that are avoided by presorting and pre-barcoding. Therefore, it is appropriate to use NAMMA delivery costs as a proxy for the metered mail Base Group.

The Commission has several reservations about the metered mail delivery cost estimate advocated by the Postal Service. The delivery cost estimate for metered letters disclosed in CHIR No. 1 is slightly higher than the delivery costs for single-piece letters (9.586 cents compared to 9.203 cents).<sup>26</sup> Since single-piece mail is less refined than metered mail, one would expect that it would be more likely to require manual sorting at the delivery unit. For this reason, the Postal Service's estimate of delivery costs for metered letters should be investigated further.

The Postal Service is unable to provide a separate estimate of delivery costs. As indicated previously, the delivery cost estimate preferred by the Postal Service is the metered mail delivery cost estimate less metered mail collection costs (5.775 cents = 9.586 cents—3.811 cents). In past dockets, the Commission has expressed reservations about the accuracy of collection cost data taken from the special City Carrier Street Time Survey that the Postal Service uses to determine the collection cost variability.<sup>27</sup> Consequently, the Commission declines to adopt the method advocated by the Postal Service in the cost avoidance calculation for the metered mail Base Group benchmark.

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<sup>26</sup> Postal Service Response to CHIR No. 1, Excel file 'ChIR.No.1.Delvry.Indicia.Collctn.xls.'

<sup>27</sup> PRC Op. R2005-1, Appendix I, Data Quality and Econometric Modeling; see *also* the discussion on collection costs at Section V. Subsection C., *infra*.



The Commission and the Postal Service have long held that the avoidable delivery costs associated with metered letters and NAMMA letters are quite similar.<sup>28</sup> Without satisfactory delivery costs for metered mail that can be directly estimated, the Commission finds that NAMMA mail is the best available estimate of the delivery costs that would be avoided by worksharing metered mail.

The use of NAMMA as a proxy for the delivery cost of the metered mail Base Group is necessary as it is the best available means of controlling for important factors unrelated to worksharing that affect delivery costs. For example, a significant source of the difference in delivery cost between any two categories of mail is the difference in the percentage of each that is delivered to an address, as opposed to delivered to P.O. Boxes or held for customer pick up, commonly referred to as nondelivered mail. Mail that is delivered to an address incurs carrier costs that an otherwise identical piece of nondelivered mail does not incur. The percentage of a category of mail that is delivered, as opposed to nondelivered, affects the average unit delivery cost for that category of mail.

The difference between the average unit delivery cost of the metered mail Base Group and the average unit delivery cost of workshared mail does not isolate the delivery savings due to worksharing, because it also reflects cost differences due to differences in the percentage of each category that is delivered, as opposed to nondelivered.

In prior proceedings before the Commission, parties have attempted to adjust average unit delivery costs to control for the differences in the percentage of delivered and nondelivered mail. Unfortunately, there are technical barriers to the development of

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<sup>28</sup> PRC Op. R2006-1, ¶ 5157; Docket No. ACR2008, Reply Comments of the United States Postal Service, February 13, 2009, at 6.

an adjustment that is conceptually rational and which retains a connection to the total delivery costs incurred by the Postal Service.<sup>29</sup>

The Postal Service's proposal makes no attempt to make any adjustment to control for differences in the percentage of delivered and nondelivered mail. Calculating avoided costs using the delivery costs proposed by the Postal Service would result in estimates that include the effects of the difference in the percentages of metered mail and workshared mail that are delivered, as opposed to nondelivered, and would therefore not isolate the savings resulting from worksharing.

The Commission does not accept the Postal Service's argument that the use of NAMMA delivery cost is invalid because the conversion mailpieces are no longer assumed to be trayed and faced. As GCA notes, traying and facing are mail processing activities and should not have an effect on delivery costs. In addition, in Docket No. R2006-1, the Commission noted that the difference in delivery costs between letter categories "arises from differences in the percentage of each category that are sorted in automated Delivery Point Sequencing (DPS) operations." PRC Op. R2006-1, at ¶ 5155. Since NAMMA's DPS percentage is similar to the DPS percentage for metered letters, using NAMMA delivery cost as a proxy for the metered mail Base Group reasonably approximates the delivery cost avoided by worksharing First-Class Mail letters.

Using NAMMA as a proxy for the delivery cost of the metered mail Base Group controls for the percentage of mail that is delivered or nondelivered. The Postal Service's cost reporting systems measure the delivery cost of First-Class Mail presort letters collectively. This reported delivery cost includes the delivery cost of NAMMA. The unit delivery cost for each category (including NAMMA) is then estimated by "de-averaging" the combined figure from the cost reporting systems based solely on the

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<sup>29</sup> For a discussion of the barriers to such an adjustment, see Docket No. R2006-1, Initial Brief of the United States Postal Service, December 21, 2006, at 257-61.

differences in the DPS percentage for each category.<sup>30</sup> As a result, the delivery cost differences between the categories estimated in this way are solely due to worksharing.

In Docket No. RM2011-5,<sup>31</sup> the Commission approved the Postal Service's request to incorporate new input data and a new bundle sorting cost methodology into the presort First-Class letter mail processing cost models. *See id.* The Postal Service recommended that the Commission incorporate the proposed modifications in the instant docket. With the new inputs, the mail flow models better estimate costs and DPS percentages for nonautomation letters processed within the Remote Bar Coding System (RBCS).<sup>32</sup>

### C. Collection

Historically, where the BMM benchmark has been employed, collection costs have not been considered costs avoidable by workshare activities. As the mail that was considered most likely to convert to presort, it was assumed that BMM was presented to the Postal Service at a Bulk Mail Entry Unit.

*Parties' positions.* The Postal Service, ABA et al., GCA, seven presort bureaus, and the Public Representative discussed whether pieces that were likely to convert to presort would ordinarily incur collection costs. ABA et al. and the presort bureaus assert that collection costs should be included as an avoidable worksharing-related cost of the Base Group. The Postal Service and GCA argue that collection costs should not

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<sup>30</sup> Letters that are sorted in the DPS operation arrive at the delivery unit in carrier walk sequence and require minimal handling before street delivery. In contrast, letters that are not sorted in the DPS operation require the carrier to manually sort them into walk sequence, and therefore incur significant additional costs.

<sup>31</sup> Docket No. RM2011-5, Order Concerning Analytical Principles for Periodic Reporting (Proposal Nine), June 3, 2011 (Order No. 741).

<sup>32</sup> The proposed modifications mitigate most of the concerns raised by MMA's witness Bentley in Docket No. R2006-1 that the mail flow models understated costs for nonautomation letters processed within the RBCS. *See* Direct Testimony of Richard E. Bentley on Behalf of Major Mailers Association, DST Mailing Services, Inc. and Association for Mail Electronic Enhancement, Inc., September 6, 2006, at 17-19.

be included. As noted below, the Public Representative expresses reservations about the studies provided by ABA et al. and Pitney Bowes.

The presort bureaus present evidence to suggest that mail likely to convert to presort is mail that would otherwise be collected by the Postal Service. For instance, Florida Mail and Printing Solutions states that it has “six vehicles traveling around 18,000 miles a month” to collect mail from its customers. Florida Mail and Print Solutions Comments at 3. Similarly, United Mailing Services, Inc. states that it has “91 vehicles on the road daily,” which “travel 7,574 miles every day.” United Mailing Services Comments at 4.

ABA et al. present results from two separate surveys that appear to corroborate the evidence presented by the presort bureaus. Taken together, this evidence supports including collection costs among the costs that would be avoided if metered mail were workshared. NAPM surveyed its members on the characteristics of mail from customers who had most recently converted to presort and found that approximately “half of all pre-conversion Single-Piece First-Class Mail required collection by the Postal Service.” ABA et al. Comments at 12.

ABA et al. present a table that displays the various ways in which mail from the surveyed customers was collected by the Postal Service. *Id.* The table shows that approximately 82 percent of conversion mail was collected at the customer’s loading dock; in tubs, sacks, or trays in the customer’s lobby; or by both methods.<sup>33</sup> In addition, the Center for Social Science Research at George Mason University (GMU) surveyed small-to-medium-size businesses to identify the characteristics and cost profile of mail that is currently being sent as single-piece First-Class letters. The GMU survey data shows that close to 60 percent of the total volume of convertible mail for small-to-medium-size non-household mailers requires collection. *Id.* at 15.

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<sup>33</sup> See ABA et al. Comments, Table 2: Mail Presented to USPS by Method/Volume, at 12.

The Postal Service argues that mailpieces that are likely to convert to presort do not incur collection costs. Postal Service Comments at 9. Accordingly, the Postal Service removes collection costs from the combined delivery and collection cost estimate provided in response to CHIR No. 1.

GCA asserts the collection costs for convertible mailpieces should be much lower than the metered mail collection cost estimate presented in response to CHIR No. 1. It further asserts that adopting those costs for the Base Group wrongly implies that conversion mail has the same collection cost as the average of single-piece metered letters as a whole. GCA Reply Comments at 16. GCA states that even if the collection costs of metered mail were an accurate reflection of the collection costs of conversion mail, using the costs provided in response to CHIR No. 1 falsely implies that collecting mail tendered in bulk quantities costs approximately the same, per piece, as collecting mail dropped in blue boxes or left for the carrier a few pieces at a time. *Id.* at 17. In addition, GCA asserts that survey results presented by ABA et al. demonstrate that conversion mail does not share the collection characteristics of all metered letters and that the conversion letters should be cheaper to collect. *Id.* at 17-18. Thus, GCA states that using average metered letter collection cost would improperly inflate Base Group costs and the resulting workshare discounts. *Id.* at 18.

The Public Representative provides comments on two of the surveys presented by ABA et al. and Pitney Bowes. The Public Representative asserts that the studies are problematic and “should not be given credence in the rulemaking.” PR Reply Comments at 2-3. The Public Representative says that there has been no demonstration that NAPM members are representative of the industry and there is no way to know how respondents to the NAPM survey were chosen. *Id.* The Public Representative further asserts that the respondents to the NAPM survey had an interest in the results of the survey, which could “negatively impact the internal validity of the survey.” *Id.* at 3.

*Commission analysis.* The Commission is persuaded that some mailpieces that are likely to convert to presort currently incur collection costs. As indicated in the comments of the presort bureaus and the results of the NAPM survey, work performed by presort firms—collecting mail from businesses and entering it at Postal Service facilities—avoids Postal Service collection costs.<sup>34</sup> Since these collection costs would be avoided if the mailpieces were converted to presort mail, the costs should be included as part of the Base Group costs. The Postal Service provides no data or analysis to support its assertion that pieces that are likely to convert to presort do not incur collection costs. As a result, the Commission concludes that some collection costs must be included in the cost avoidance calculation.

The Commission agrees, in part, with GCA's assertion that the metered mail collection costs presented in response to CHIR No. 1 appear to overstate the collection costs of conversion mailpieces. The Postal Service's response to CHIR No. 1 indicates that stamped mail and metered mail collection costs are 3.844 cents and 3.811 cents, respectively. This implies that the collection costs for metered letters are approximately equivalent to the collection costs for stamped letters. As many parties note, metered mail Base Group letters are frequently tendered to the Postal Service at a customer's loading dock (or in trays, sacks, or tubs at an office). See United Mailing Services Comments at 4-5; ABA et al. Comments at 12. Thus, it is reasonable to conclude that collecting metered mail Base Group letters would be less costly than collecting single-piece First-Class letters that are often tendered by a household a few at a time.

The costs of metered mail provided by the Postal Service appears to overstate the collection cost of mail likely to convert to presort. Because the empirical data presented by ABA et al. indicates that approximately 60 percent of the mail that is likely to convert to presort requires collection, the Commission will incorporate 60 percent of the metered mail collection cost estimate provided by the Postal Service in response to

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<sup>34</sup> In addition, the GMU survey demonstrates that small-to-medium-size businesses use single-piece First-Class Mail that requires collection.

CHIR No. 1 as the best currently-available estimate of metered mail collection costs. Based on the FY 2010 costs provided in that response, this results in a collection cost figure of 2.287 cents for the metered mail benchmark. Updating for FY2011 costs results in a figure of 2.410 cents.<sup>35</sup>

The Commission is sensitive to the Public Representative's reservations with the GMU and NAPM surveys provided by ABA et al. ABA et al. could provide only a limited amount of information concerning its surveys which prevents the Commission from fully testing the impact of the Public Representative's concerns. However, the Commission observes that the results of the surveys are consistent with the evidence presented by the presort bureaus that some First-Class mailpieces that are likely to convert to presort would incur collection costs. Therefore, without a convincing reason from the Postal Service as to why collection costs should be excluded, the Commission concludes that some collection costs should be included in the avoidable cost for the metered mail Base Group. In addition, at the other end of the spectrum, the Commission concludes that incorporating 100 percent of the metered mail collection cost estimate provided in response to CHIR No. 1 would overstate the collection costs of conversion mailpieces. The Commission finds that the ABA et al. studies represent the most reasonable attempt to determine the percentage of metered mail Base Group letters that incur collection costs. For this reason, the Commission estimates that the cost of collecting First-Class letters that are likely to convert to presort is 60 percent of the collection cost of metered letters.<sup>36</sup>

The Commission agrees with the assertion made by many parties that the cost characteristics for the Base Group, to the extent possible, should be readily traceable to

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<sup>35</sup> Where possible, to reflect FY2011 costs, the Commission updates the workpapers the Postal Service provided in support of its response to CHIR No. 1. Unless an improved collection cost estimate is proposed and approved prior to the filing of its next First-Class Mail workshare rate adjustment or FY2012 Annual Compliance Report, the Postal Service should update the metered mail collection cost workpapers provided in response to CHIR No. 1 reflect the latest cost data.

<sup>36</sup> The Commission notes that in deciding on a discount, the Postal Service is free to passthrough less than the avoided costs.

the Postal Service's existing cost systems and, therefore, proxies are not ideal.<sup>37</sup> Nevertheless, considering the evidence on the record that collection costs are incurred by benchmark mail, the Commission will use a proxy to represent the cost of collecting mailpieces that are likely to convert to presort. The Commission expects that a more accurate estimate of collection costs will be developed in future rulemakings that update analytical costing principles. See Docket No. RM2011-3.

#### D. Summary of the Avoidable Costs of First-Class Worksharing

In place of the BMM Base Group for presort letters, the Commission adopts a broader metered mail category that includes metered, IBI, and PVI letters. The metered mail Base Group includes three sources of costs avoidable by worksharing—mail processing, delivery, and collection. For mail processing costs, the Commission will use the mail processing costs associated with metered letters. For delivery costs, the Commission will use the NAMMA category as a proxy for the metered mail Base Group. For collection costs, the Commission will use 60 percent of all metered mail collection cost estimate. These costs are displayed in the table below.

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<sup>37</sup> The Commission has previously questioned the accuracy of the collection cost estimates for First-Class letters. In Docket No. R2005-1, the Postal Service presented its City Carrier Street Time Survey (CCSTS), which estimated the collection costs for city carriers. The Commission expressed reservations about the accuracy of the data and the validity of the econometric models used to develop the collection cost variability estimates. The Commission noted that the data used to develop the estimates contained a large proportion of errors and anomalies, and that the model used to estimate the collection cost variability coefficient should be improved. PRC Op. R2005-1, Appendix I. Furthermore, the Commission noted that the “dramatically higher estimate of collection costs on regular routes warrants caution in accepting the results of the Bradley study.” *Id.* ¶ 4018.



Selected First-Class Mail Letters					
Summary of FY 2011 Avoidable Unit Costs					
	Mail Processing	Delivery	Collection	Total	Incremental
	Avoidable	Avoidable	Avoidable	Avoidable	Avoided
	Unit Cost	Unit Cost	Unit Cost	Unit Cost	Unit Cost
	(cents)	(cents)	(cents)	(cents)	(cents)
	[1]	[2]	[3]	[4]	[5]
<b>FCM Letter Categories</b>					
Metered Mail Baseline Group	12.101	4.808	2.410	19.320	
Automation MAADC Presort Letters	8.539	5.004	0.000	13.543	5.777
Automation AADC Presort Letters	6.682	4.715	0.000	11.397	2.146
Automation 3-Digit Presort Letters	6.326	4.704	0.000	11.029	0.368
Automation 5-Digit Presort Letters	4.069	4.503	0.000	8.573	2.457
<b>Note:</b> The incremental avoided cost [column 5] of each more finely sorted rate category is determined by subtracting its avoidable cost [column 4] from those of the category above it. For example, to obtain the avoided cost of Automation MAADC letters, its avoidable cost is subtracted from the avoidable cost of the Metered Mail Baseline Group.					
<b>Sources:</b> [1] and [2] - Docket No. ACR2011, Response to CHIR No. 1, question 2.					
[3] - Updated from Docket No. RM2010-13, Response to CHIR No. 1, adjusted as described in Section V.C.					

## VI. PROPOSALS TO MODIFY EXISTING COST MODELS

In Order No. 537, the Commission stated that this docket will consider technical proposals to refine the manner in which avoided costs are modeled. The Commission received five separate proposals. Each proposal is discussed below.

*Background.* The In Office Cost System (IOCS) records labor cost information in a form that allows it to be associated with broad products and services. It does not, however, record costs that are sufficiently detailed to be associated with the various price categories of presort First-Class Mail. To develop attributable mail processing costs for each price category, the attributable mail processing cost for a product like presort First-Class Mail calculated in the Cost and Revenue Analysis (CRA) report must be de-averaged into its component price categories. To do this, the Postal Service uses special studies in combination with a “bottom up” engineering model to estimate the costs of price categories.

Special studies are used to determine the processing characteristics of a typical batch of 10,000 letters presorted to the particular level under study. For example, if the 3-Digit presort tier is under study, the engineering model assumes that this batch of letters will have system average processing cost characteristics for 3-Digit presort First-Class letters.<sup>38</sup> The established model disaggregates processing costs into more than 40 pools. In general, each pool captures labor time spent on a specific mail processing task—for example, postage canceling or barcode sorting.<sup>39</sup>

The model consists of a downflow density map that shows the flowpath that various portions of the typical 10,000-piece 3-Digit mailing will take through the set of

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<sup>38</sup> The model assumes that a batch of 10,000 3-Digit presort First-Class letters will have typical densities to various destinations (which will determine how many processing steps will be needed) and have typical physical characteristics (which will determine how likely it is that particular kinds of sorting machines will reject these letters, requiring re-feeds or manual processing).

<sup>39</sup> For a description of all cost pools, see the Summary Description of USPS Development of Costs by Segments and Components, Fiscal Year 2010.

more than 40 possible processing operations prior to delivery. Using the productivity of the machines associated with each processing operation, the model calculates the labor time required to process a letter in each substream of 3-Digit letters in each processing operation that it passes through. It multiplies this by the applicable wage rate. In this way, the model calculates a total unit cost for each flowpath. The model then combines flowpath unit costs into a weighted average unit processing cost for 3-Digit presorted First-Class Mail as a whole. An example of this model is provided in the Appendix.

The machine productivities and labor hours that yield modeled processing costs come from the Management Operating Data System (MODS) and are self-reported. CRA costs come primarily from IOCS tallies that are collected by trained data collectors. The modeled processing costs for price categories, when aggregated, differ from the corresponding CRA processing costs. Thus, there is a need to “true up” modeled costs for a given presort level to the CRA costs. To do this, the CRA mail processing cost is separated between costs that vary with both the level of presort and the number of pieces, and costs that vary only with the number of pieces. For the purpose of truing up the modeled costs, the former costs are referred to as “proportional costs” and latter are referred to as “fixed costs”—meaning fixed per piece. Modeled costs are multiplied by a proportional adjustment factor. To that result, a per-piece fixed cost is added.

The truing up adjustment also distinguishes between workshare-related and non-workshare-related costs. Presorted letters do not pass through every mail processing operation. In addition, not every processing operation that presorted mail passes through is affected by presorting. Accordingly, since Docket No. R2006-1, the Commission has treated the cost pools in the letter cost model as either workshare-related (proportional), workshare-related (fixed), or non-workshare-related. See PRC Op. R2006-1, ¶ 5161. Workshare-related (proportional) cost pools, are cost pools whose activities and their associated costs are either incurred or not incurred depending on the level of presort of the batch of mail being modeled. Workshare-related fixed cost pools represent mail processing costs incurred by workshared mail regardless of the

level of presort being modeled. Non-workshare-related cost pools are assumed to be unrelated to worksharing activities and are omitted from the avoided cost calculation.

Under the established model, piece sorting operations are treated as proportional, while forwarding, accepting, and customer service activities are treated as fixed. Since Docket No. R2006-1, the Commission has concluded that although allied/support<sup>40</sup> and unexpected<sup>41</sup> costs pools are not modeled, they are much more likely to vary indirectly with presort level than to remain fixed. PRC Op. R2006-1 147-48. Therefore, the established letter cost model assumes that allied/support activities vary indirectly with presort level.

The degree to which allied/support costs vary with presort level cannot be determined directly because they are not modeled. The Commission assumes that they vary to the same degree that average unit processing costs for presort First-Class Mail vary by presort level. The established methodology distributes allied/support and unexpected costs to workshare price categories in the same proportion that it distributes proportional, fixed, and non-workshare-related costs to those categories. Assigning indirectly caused costs to price categories in proportion to directly caused costs is known as “piggybacking.” The true up procedure incorporates this approach.

#### A. Postal Service Proposal

*Proposal.* The Postal Service proposes that cost pools be treated as either proportional or fixed with respect to presort level based on the task that the pool as a whole performs. It contends that there is no accurate way to distinguish between proportional and fixed costs within a given pool. However, if the task that the cost pool

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<sup>40</sup> Allied/support costs pools are primarily the costs of unloading mail in bulk containers from trucks, moving the containers to sorting operations, putting sorted mail back into bulk containers, and loading them back onto trucks.

<sup>41</sup> Unexpected cost pools are the costs of flats recorded as having been sorted in an operation designed only to sort letters, or the costs of letters recorded to have been sorted in an operations designed to sort only flats.

performs has not been modeled, the Postal Service proposes that the Commission make the default assumption that it is fixed with respect to presort level. Postal Service Comments at 20.

The Postal Service also proposes a change in the treatment of costs in unexpected cost pools. The established methodology distributes unexpected letter costs to price categories by piggybacking them on the distribution of average unit presort First-Class Mail letter processing costs. It piggybacks unexpected flat costs on average presort First-Class Mail flat processing costs. The Postal Service proposes that the Commission make the default assumption that unexpected costs are entirely proportional. It recommends this treatment largely as a matter of convenience, as unexpected costs are so small that their treatment has little impact on estimated unit cost avoidances. *Id.* at 21.

The Postal Service argues that piggybacking the allied/support cost pools on modeled costs, as the established method does, arbitrarily separates the allied/support pools into workshare-related proportional, workshare-related fixed, and non-workshare-related. *Id.* at 16-21. The Postal Service asserts that its proposal to assume those costs are fixed confines avoided costs more closely to costs caused by worksharing alone. It contends that assuming that allied/support cost pools are fixed reduces the “artificial enlargement of the CRA adjustment factor” that it believes occurs when unmodeled cost pools are treated as partly proportional and piggybacked on modeled costs. *Id.* at 18-20.

The primary support that the Postal Service offers for its view that allied/support costs are fixed with respect to presort level is its descriptions of the tasks performed in four of the 26 cost pools that it asks the Commission to reclassify as fixed. The four pools that it describes are the “MODS 1PLATFORM,” “non-MODS ALLIED,” “MODS 1TRAYSORT,” and “MODS 1PRESORT” pools. It suggests that the activities it

describes in these four allied/support cost pools are representative of the 26 pools that would have to be reclassified as fixed if the Commission were to accept its proposal.

In the four cost pools described, the Postal Service says, presorted letters in bulk containers (pallets, sacks, rolling stock, and trays) are loaded and unloaded from trucks, given a crude sort depending on which operation they will go to next, and loaded back onto trucks. It reasons that the cost of moving letters in containers from the dock to the sorting operations and back will depend on the number of containers and the number of times each container is moved.

According to the Postal Service, the number of containers needed is determined by the volume of letters to be moved, which the model takes as a given. The number of times each container will be moved is determined by how many facilities the container passes through prior to delivery. The Postal Service contends that the number of facilities the containers pass through will not be affected by how finely the letters within the containers are sorted. *Id.* at 17-20.

*Positions of the participants.* The Public Representative and Pitney Bowes comment on the Postal Service's proposal. The Public Representative quotes portions of the Postal Service's analysis of three specific cost pools and finds its explanation of their fixity with respect to presort level "persuasive." PR Reply Comments at 3.

Pitney Bowes argues that the Postal Service's proposal is without merit and should be rejected. Pitney Bowes Reply Comments at 5. In Docket No. R2006-1, it argued that allied/support costs should be expected to vary indirectly with presort level because their function is to support distribution operations, whose costs clearly vary directly with presort level. Pitney Bowes supported its position with an analysis of the behavior of CRA unit processing costs for single-piece First-Class Mail versus presort

First-Class Mail. It also supported its view with a detailed qualitative analysis of seven types of allied cost pools.<sup>42</sup>

Pitney Bowes says that the Postal Service did not respond to this evidence in either Docket No. R2006-1 or the current docket. It argues that if the Postal Service wanted the Commission to change the established method of treating allied/support costs, it has had ample time since Docket No. R2006-1 to explicitly model how those costs vary by presort level. *Id.* n.6. For all these reasons, it argues, the Postal Service fails to meet its burden to justify reclassifying the costs pools. Pitney Bowes Comments at 5, 12.

Pitney Bowes also seeks to reinforce the basic intuition that allied/support costs vary with the sorting operations that they are designed to support by arguing that the Postal Service itself relies on that intuition in its analysis of attributable mail processing costs. It quotes Postal Service witness Bozzo in Docket No. R2005-1 where he explains that allied operations consist primarily of moving mail to and from sorting operations, and that those activities vary in proportion to the sorting activity that they support. Pitney Bowes Reply Comments at 11, citing Docket No. R2005-1, USPS-T-12 (Bozzo) at 14.

Pitney Bowes supports its conclusion that allied costs vary in proportion to direct sorting costs by updating the quantitative analyses that it presented in Docket No. R2006-1. In Docket No. 2006-1, it observed that generally, the effect of presorting on letter processing costs is reflected in the difference between the unit costs of single-piece and presort First-Class. Therefore, it argued, if allied/support costs do not vary with presort level, as the Postal Service alleges, one would expect the allied/support costs for unworkshared letters to be similar to those that are workshared. *Id.* at 8-11. It

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<sup>42</sup> *Id.* at 24-29. The cost pools analyzed were Letter Tray Sorting Operations – Mechanical Tray Sorters/Robotics, Dispatch Operations, Opening Unit Manual Transport Operations, Scanning Mail Operations, Platform Operations, Allied Labor Operations, and Miscellaneous and General Support Operations.

provides updated tables that it says confirm that allied/support costs are highly variable with presort level. The tables it provides for FY 2010 show that in 30 of the 34 cost pools that the Postal Service considers fixed, unit processing costs decrease moving from single-piece to presort First-Class letters, and decrease at essentially the same rate as proportional costs. *Id.* at 9.

As its principal support for asserting that allied/support costs do not vary with presort level, the Postal Service offers a description of some of the tasks performed in four cost pools that it implies are representative of allied/support pools generally. Pitney Bowes argues that the Postal Service's description of the operations performed in these pools is selective and incomplete. It argues, for example, that the Postal Service limits its discussion of the "non-MODS ALLIED" cost pool to platform activity, ignoring the "collection activities, moving mail to/from other operations, separating/breaking down mail, other allied activities" that are also performed in this cost pool.<sup>43</sup> It notes that moving mail to and from other operations is an activity that, by the Postal Service's own admission, is driven by the level of sorting activity, which, in turn, is driven by variations in presort level. Pitney Bowes Reply Comments at 13.

Similarly, Pitney Bowes argues that the Postal Service's discussion of the "MODS PRESORT" cost pool is limited to the sorting of trays into rolling stock. It notes that this pool is a catch-all pool that includes "activities related to handling of presort mail volumes, including traying or banding of presort mail,"<sup>44</sup> and even includes some processing of single-piece mail. Finer levels of presorting, Pitney Bowes suggests, should require less of this array of activities. *Id.* at 14.

In describing operations in selected allied/support cost pools, the Postal Service focuses on platform-related activity. It asserts that it is the nature of platform activity not

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<sup>43</sup> See Summary Description of Development of Costs by Segment and Component, July 1, 2010, at 3-11.

<sup>44</sup> *Id.* at 3-7.



to vary with presort level, but only with the number of processing facilities that presort mail passes through prior to delivery. Pitney Bowes argues that this assertion is false in several ways. It concludes, as the Commission did in Docket No. RM2009-3, that density and level of presort are integrally related and mutually dependent and that this must be recognized when the cost effects of presorting are measured for purposes of evaluating workshare discounts.<sup>45</sup> It confirms that the densest mailings are those submitted with the highest percentage of 5-Digit presorted mail.

Using its own experience as an example, Pitney Bowes observes that presort First-Class mailings dense enough to require multiple pallets are often made up entirely of 5-Digit presorted letters. It describes the platform-related tasks that such high-density, finely-presorted mailings avoid. It says that such mailings are typically pallet-sorted to destination according to schemes prescribed by the Postal Service. It quotes the Postal Service's own operational witnesses in other dockets recognizing the many platform-related tasks that such mailings avoid. It says that the allied/support tasks that can be avoided by multiple-pallet mailings include tray sorts at the platform of the originating processing plant. If pallets are sorted in a way that they bypass the originating plant altogether, there is no need to enter, stage, and break down pallets; sort trays into rolling stock; then stage, and load the rolling stock back into trucks. If pallets are sorted in a way that they bypass both originating and intermediate plants, these same processing tasks are avoided at intermediate plants as well. For these

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<sup>45</sup> See *id.* at 14. There, Pitney Bowes observed

In Docket No. RM2009-3, the Commission concluded that "the four workshare characteristics named in section 3622(e) include integral associated workshare characteristics. If mail with one of the four workshare characteristics named in section 3622(e) must also have an integrally-related characteristic in order to avoid all of the costs that the named workshare characteristic is designed to avoid, the associated characteristic will be included in the avoided cost calculation. . . [and that] density is sufficiently related to presorting to satisfy the guidelines, at least in the context of First-Class Mail."

reasons, it says, highly-presorted mailings are more likely to avoid platform-related costs than more crudely presorted mailings. Pitney Bowes Reply Comments at 14-16.

*Commission analysis.* The Commission concludes that the established method of allocating allied/support costs to presort categories in the letter cost model is a better approximation of how those costs vary with presort level than the Postal Service's assumption that they are entirely fixed. The Commission finds that the Postal Service's descriptions of allied/support operations are incomplete and inaccurate, and that the more thorough analysis of those operations by Pitney Bowes confirms that they vary substantially with presort level. Until the Postal Service explicitly models allied/support costs, the Commission will adhere to the established piggyback method of distributing those costs.

The established piggyback method for distributing allied/support costs to the various price categories of presort First-Class Mail grew out of litigation of a proposal made by Pitney Bowes in Docket No. R2006-1 to add some 14 cost pools (many of them allied) to those considered to be entirely proportional.<sup>46</sup> In opposition to that proposal, the Postal Service made essentially the same arguments that it makes here that allied/support costs should be classified as entirely fixed. The established methodology, which treats allied/support costs as responding to presort level to the same degree as all other mail processing costs respond to presort level, is a middle ground between the positions taken by the Postal Service and Pitney Bowes in Docket No. R2006-1.

Unlike piece sorting operations, the volume and productivity of most allied/support operations have not been directly measured. In addition, allied/support operations are less well-defined and less standardized than piece sorting operations from an engineering standpoint. For these reasons, they are difficult to model. Cost

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<sup>46</sup> See Docket No. R2006-1, PB-T-2 (Buck), October 25, 2006, at 13-31.

avoidance analysis, therefore, relies primarily on operational inferences as to how allied/support costs vary with presort level.

How mail processing labor costs vary with presort level and how they vary with volume are distinct fields of study, but they overlap in basic respects. One area of overlap is an assumption that the level of allied/support activity is dependent on the level of activity that occurs in the piece sorting operations that they support.

From an operational standpoint, the major elements of allied/support activity are moving mail from a loading dock to various sorting operations, preparing the mail for induction in those operations, and then moving sorted mail back to the dock. The Commission's assumption that labor costs in most mail processing operations are 100 percent volume variable does not require specific analysis of the dependence of such allied/support operations on the level of the piece sorting operations that they support. The Postal Service, however, has made recent attempts to econometrically model the volume variability of mail processing labor costs. In the process, it has observed that

Insofar as each piece fed [to a piece-sorting operation] must be brought to and dispatched from the operation, related container handlings . . . will also be proportional to [Total Pieces Fed], as will "overhead" not-handling time that is driven by handling workhours.

Docket No. R2005-1, USPS-T-12, at 14. Based on its engineering judgment that the level of the major element of allied/support activity depends on the level of the piece sorting activity that it supports, the Postal Service "piggybacked" the volume variability of allied/support costs on the cost-weighted average of the volume variability that it measured for its direct sorting operations.<sup>47</sup>

The inference that the level of this aspect of allied/support activity depends on the level of the direct sorting activity that it supports is applicable to cost avoidance

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<sup>47</sup> See Docket No. R2005-1, USPS-T-11 (Van-Ty-Smith), at 29.

modeling. The level at which a mailing is presorted determines the number of direct sorting operations that it will require before it is delivered. Therefore, it is reasonable to assume that mail processing labor costs incurred by allied operations will vary in rough proportion to the number of sorting operations that they undergo.

As noted, the Postal Service's operational analysis focuses on tasks performed on the platform. The Commission recognizes that of all the various tasks performed in the allied/support cost pools, platform costs are the least likely to vary with presort level. But the Postal Service's own operational witnesses have shown that even platform-based tasks are avoided by highly presorted mail. See Docket No. R2005-1, Tr. 5/1642, 1644, 1645 (McCrery responses to interrogatories).

The Commission is not persuaded by the Postal Service's claims that the current method of piggybacking allied/support and unexpected costs on modeled costs is arbitrary. The costs associated with these activities are incurred to support all processing operations, including the sorting operations. The Commission remains convinced that distributing allied/support and unexpected costs in the same proportions as all other costs is the best approximation of the effect that presort level has on those costs. See PRC Op. R2006-1, ¶ 5160. In addition, the Commission notes that a similar mail processing cost pool allocation methodology that piggybacks nonmodeled costs on all other costs is used in the parcel cost models for Standard Mail, Parcel Select, and Parcel Return Service.<sup>48</sup>

#### B. Association for Postal Commerce Proposal

*Proposal.* PostCom recommends that the Postal Service develop product costs using a "bottom-up" rather than a "top-down" approach to estimating the costs of

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<sup>48</sup> See Order No. 658, Docket No. RM2010-12, Order On Analytical Principles Used In Periodic Reporting (Proposals Three Through Eight), January 28, 2011, Proposal Seven at 13-14; see *also* Order No. 719, Docket No. RM2011-6, Order on Analytical Principles Used In Periodic Reporting (Proposals Thirteen and Fourteen), April 28, 2011, Proposal Thirteen at 7.

workshare categories that focuses on cost incurrence, rather than cost avoidance. Under its proposal, the cost basis of discounts would be the difference in the workshare categories' "directly attributable" costs. Indirectly attributable costs would apparently be excluded.<sup>49</sup>

PostCom explains that a bottom-up costing approach identifies the cost of the product that requires the least Postal Service handling, measures the work performed for the next upstream operation, and then adds this unit cost to determine the cost of the next product. For categories that the Commission determines are in a worksharing relationship, the cost basis of discounts would be the difference in their respective "direct attributable costs."

PostCom argues that implementing bottom-up costing would result in more accurate estimates of the costs incurred in processing different types of mail and would allow for the development of more rational price relationships between different types of mail. PostCom emphasizes that under its proposal, each product would be assumed to serve a unique market, and prices would be determined by marking up that product's directly attributable costs according to demand factors. Prices would automatically reflect the principles of ECP, and workshare discounts would no longer be necessary. PostCom Comments at 7-8; PostCom Reply Comments at 7-8.

PostCom asserts that the basic data systems which supply the inputs to the cost avoidance mail flow models, such as MODS and the IOCS, are "entirely and indisputably inaccurate" and that the models themselves "bear little if any relation to how mail actually moves through the system." PostCom Comments at 9, 11. It argues that to effectively implement bottom-up costing, the Postal Service must improve its ability to measure costs. *Id.* at 8. PostCom asserts that if the Postal Service improves

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<sup>49</sup> "The primary advantage of using bottom-up costing is that this approach tracks only those costs directly attributable to processing a piece of mail." PostCom Reply Comments at 7.

the adoption rate for IMb, it could use IMb to track its mail flows and develop cost estimates that accurately reflect the reality of mail processing. *Id.* at 11.

Finally, PostCom says that shifting to bottom-up costing that is confined to “directly attributable costs” will be beneficial even if the Commission continues to embrace the concept of discounts based on worksharing relationships between mail categories. It argues that this approach will yield a more reliable method of measuring a product’s processing costs, as well as the costs that it avoids due to its workshared characteristics. *Id.* at 8-9.

*Parties’ positions.* Valpak supports some aspects of PostCom’s proposal, although it argues that PostCom does not adequately consider the relationship of costs incurred with costs avoided. It notes that avoided costs are by their nature hypothetical, but that they are estimated by comparing the costs that real mail of different types and levels of refinement actually incur. Valpak Reply Comments at 3-4. Valpak observes that it is feasible based on current costing methods to determine the relative cost of workshared categories by adding the cost of processing elements from the bottom up, rather than subtracting them from the top down.<sup>50</sup> It states that “one might assume that within Standard Mail, bottom-up costing using available data for costs incurred certainly would be no worse, and probably better than, top-down costs avoided.” *Id.* at 4-5. Valpak asserts that using bottom-up costing based on existing analytical methods to estimate relative prices of workshared categories of Standard Mail would “be more business-like and the cost basis for price differentials would be more transparent.” *Id.* at 10.

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<sup>50</sup> Although Valpak agrees that it is feasible based on current costing methods to determine the relative cost of workshared categories by adding the cost of processing elements from the bottom up, rather than subtracting them from the top down, it notes that this would not necessarily lead to the result that PostCom seeks. For workshared categories costed in this manner, prices would still be subject to the section 3622(e) cap. Therefore, price differences would still have to be equal to or less than differences in the Postal Service’s costs. *Id.* at 7, 10.

Valpak agrees with PostCom that IMb could potentially provide for accurate mail flow data at a greater level of detail than is available now. It notes, however, full service IMb is used by only a little more than a third of Standard Mail. It urges the Postal Service to offer an effective rate incentive for converting to full service IMb, or to switch to an alternative performance measuring system such as the Radio Frequency Identification (RFID) technology on which the UNEX system is based. *Id* at 8-10.

*Commission analysis.*

**Technical aspects of the proposal.** The Commission agrees with Valpak that there is no inherent drawback to estimating the relative cost of workshared categories of mail by starting with the most workshared variant of a particular mail service and adding the increments of cost incurred by each successively less workshared tier. The Commission also agrees that estimates of costs incurred using current analytical methods could be used to identify the total attributable costs of each tier. If comparing the total attributable cost of each tier would make the Postal Service's pricing decisions more "transparent" and more "business-like," as Valpak anticipates, it would be worthwhile to pursue.

It may be possible to develop a bottom-up approach to estimating comprehensive attributable costs for the Standard Regular letter mail price categories that could provide an alternative technique for estimating avoidable cost differences between those categories for purposes of evaluating workshare discounts. If the Postal Service, PostCom, Valpak, or any other interested party were to develop a proposal beyond the conceptual level with rate category calculations using bottom-up costing, the Commission would establish a rulemaking to consider such a proposal.

The Commission notes, however, that it currently estimates workshare category costs using engineering models instead of measuring them directly out of necessity, rather than preference. The Postal Service's MODS and IOCS data systems generally cannot disaggregate costs to the levels needed for the various workshared variants of

Standard Mail. Full service IMb, if it were adopted widely enough to provide truly representative data, might allow piece volumes of workshared categories to be tracked through discrete 3-Digit MODS operations. Tracking rate category piece handlings disaggregated at the level of 3-Digit MODS operations, however, is not likely to provide a sufficient basis for directly estimating attributable costs at that level. Hours would also need to be disaggregated to the same level in a reliable way. The Postal Service has observed in the course of its volume variability modeling of mail processing costs that employees do not reliably reclock as they move between 3-Digit MODS operations over a processing tour. The consequence is that data on hours spent in a processing operation must be aggregated to a higher level before they can be estimated with confidence.<sup>51</sup> Any informal rulemaking initiated to revise established analytical costing principles as PostCom and Valpak suggest would need to address such issues.

To the extent that PostCom's proposal advocates the exclusion of indirectly attributable costs from the calculation of total workshare category attributable costs, the Commission notes that this would shift a substantial portion of attributable costs to the institutional pool. In the Commission's view, this would impair, rather than improve efforts to accurately trace cost responsibility to products, and make it difficult to apply the principles of ECP in a meaningful way.

**Legal and policy aspects of the proposal.** PostCom argues that purchasers of Standard Mail do not take into account the benefits of greater or lesser extents of worksharing when deciding whether to purchase mail service. It argues that their decisions to purchase mail service are based on a more basic calculation of overall return on investment based on expected response rates from the targeted market, and overall costs of producing mail, only one of which is postage. It describes what amounts to a hierarchy of purchaser concerns starting with a decision as to whether to use mail or an alternative advertising channel, followed by a decision whether to use a

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<sup>51</sup> PRC Op. R2006-1, ¶¶ 3037-42.



targeted or a saturation form of Standard Mail service. PostCom Reply Comments at 4-7. It asserts that mailers do not “make their presort and drop entry decisions based solely on the pricing of the discounts available for performing those activities,....” It observes that such things as mailing list and printing costs are also factored into a mailer’s decisions to use the mail. It contends that the fact that the mailer considers non-postage costs in his decision to buy mail service invalidates the ECP-based efficiency calculus.<sup>52</sup> PostCom also asserts that a Standard mailer will often purchase a category of service in which discounts are considered together (presorting plus drop shipping). It suggests that this also invalidates the ECP-based efficiency calculus. PostCom Comments at 5-6.

The Commission has long understood that there is a hierarchy of factors that a Standard mailer takes into account when deciding whether to purchase a particular mail service that involves worksharing. The level of a workshare discount relative to a less workshared variant often is not at the top of that list. Moreover, some mailers may consider the price of a bundle of worksharing characteristics rather than the price of one in isolation.

However, the logic of the ECP rule focuses on incremental effects.<sup>53</sup> Once a mailer has chosen mail over other advertising channels, and then chosen to purchase a targeted over a saturation service, decisions remain as to whether to presort beyond the 3-Digit level, and whether to dropship to various levels. Even though a mailer has non-postage costs, a rational mailer will decide how much presorting or dropshipping to engage in by determining its additional cost of supplying a particular level of presorting or dropshipping and then comparing it to the discount offered. If considering both

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<sup>52</sup> *Id.* at 6. PostCom offers a hypothetical illustration of its argument by describing a Standard mailer that is incentivized to shift away from saturation mail to targeted mail (5-Digit Regular) in response to an increase in the price of saturation mail relative to 5-Digit Regular, but factoring in the added cost of purchasing a mailing list with which to target his 5-Digit Regular mailing.

<sup>53</sup> Docket No. R2006-1, Revised PB-T-1, Direct Testimony of John C. Panzar on Behalf of Pitney Bowes Inc., October 31, 2006.

presorting and dropshipping a mailing, a rational mailer will determine its additional cost of supplying both, and compare it to the aggregate discount. In either circumstance, the logic of the ECP rule holds.

PostCom urges the Commission, when overseeing the application of the pricing standard of section 3622(e), to forego the task of identifying worksharing relationships among products that serve similar markets in a similar way, and therefore have common demand characteristics. It asserts that the Commission should adopt the view that every rate category serves a unique market and has unique demand characteristics, and therefore should be priced without reference to the prices charged for other rate categories. It proposes to reconcile this view with section 3622(e) by bringing pricing for all products within the exception articulated in section 3622(e)(2)(D).

PostCom's suggestion that section 3622(e)(2)(D) provides an exception that would allow workshare rate categories to be priced without reference to other rate categories is not fully developed. The section cited allows workshare discounts to exceed avoided costs where "reduction or elimination of the discount would impede the efficient operation of the Postal Service." As the Commission explained in Docket No. R2008-1, the argument that operational efficiency is improved by having a mailer perform a worksharing activity when the Postal Service can perform the same activity at a lower cost is flawed. Order No. 66 at 34-35.<sup>54</sup> The exception for operational efficiency may be justified "if the Postal Service [has] capacity issues such that it could not effectively process the large amount of mailpieces anticipated by an extremely low rate difference" or "similar explanations of unusual operational circumstances." *Id.*; see also 2009 Annual Compliance Determination at 72. PostCom does not identify the type of circumstances that have been found to potentially qualify for the cited exception, nor does it provide an alternate explanation of how the exception would apply to its proposal.

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<sup>54</sup> Docket No. R2008-1, Review of Postal Service Notice of Market Dominant Price Adjustment, March 17, 2009 (Order No. 66).

PostCom's proposal would discard the concept of cost avoidance that underlies the established model for estimating the cost basis of workshare discounts. In fact, it would discard the premise that underlies workshare discounts themselves, *i.e.*, that services that fill the same market need, but at different costs, should be priced to bear the same institutional cost burden, after adjusting for differences in avoided cost. The premise of this approach to setting discounts is that it maximizes society's productive efficiency. The legal implications of any specific application of PostCom's bottom-up pricing concept would have to be examined along with its technical feasibility.

### C. Greeting Card Association Proposals

GCA recommends two cost model modifications: (1) the Postal Service should directly measure the costs of 5-Digit presort letters; and (2) the rate category, Mixed Automated Area Distribution Center (MAADC) letters, should be replaced as the initial reference point for First-Class workshared letters.

#### 1. Directly Measure Costs for 5-Digit Presort Letters

*Proposal.* GCA proposes that the Postal Service directly measure the cost of the 5-Digit presort letter rate category through the use of IMb data rather than derive it from its engineering models of avoidable cost. It argues that the costs avoided when Base Group mail is converted to lesser levels of presortation (MAADC and AADC) are difficult to measure, and that the estimates of those avoided costs are unstable. It contends that the most reliably measured cost avoidance relationship is the one between the Base Group and 5-Digit presort—the highest volume and most stable category. GCA Comments at 14-15. GCA also believes that changes in the cost pool classifications lead to large shifts in the proportional adjustment factor. It believes that directly measuring the costs of 5-Digit mail using IMb data would significantly improve the statistical quality of those costs and make them “immune to the pendulum swings in cost pool classifications.” *Id.* at 29-31.

*Parties' positions.* Pitney Bowes agrees with GCA that the relative costs of the various tiers of automation letters should be directly estimated using IMb data rather than modeling techniques. It proposes to apply this approach not just to the 5-Digit price category, but to all other price categories of presorted First-Class letters (Mixed MAADC, AADC, and 3-Digit). It believes that sufficient volume exists to allow the costs for each automation letter rate category to be directly measured with an acceptable level of sampling error. Pitney Bowes Reply Comments at 19.

*Commission analysis.* If it were feasible, directly measuring the costs for 5-Digit and other automation letter rate categories would be a substantial improvement over relying on engineering models. GCA's proposal would likely mitigate the effects of the proportional adjustment factor and it would improve the mail flow models. This, in turn, would lead to more accurate cost avoidance calculations and workshare discount setting. The adoption rate for full service IMb, however, would need to increase to the point that the data can be safely regarded as representative of First-Class Mail generally. As discussed above in connection with PostCom's "bottom up" costing proposal, a fully formed direct measurement proposal would need to include a means of assigning costs to the mail flow information obtained from IMb. In particular, one would have to find a reliable way to associate hours incurred in 3-Digit MODS operations with the rate category handlings observed there. One would also have to find a way to measure the costs of activities that do not generate IMb scans at this highly disaggregated level.

GCA suggests that planning for the use of IMb data in First-Class letter cost models should begin now so that the change can be implemented when IMb usage increases to a level that would enable statistically reliable samples. GCA Comments at 30. The Commission agrees that such planning would be beneficial.

2. MAADC Should Not Be the Initial Reference Point for First-Class Workshared Letters

*Background.* The established methodology may be thought of as an incremental analysis applied from the “top down.” It uses an incremental analysis to calculate the costs avoided by each successively finer level of presorting.<sup>55</sup> The workshare-related cost of MAADC letters are subtracted from those of the BMM Base Group to evaluate the MAADC discount. Then, worksharing-related savings for each more finely sorted rate category are determined by subtracting its workshare-related cost from those of the category above it. Discounts are evaluated by comparing the difference in the discount for each successively finer presort level to the difference in cost for each successively finer presort level.

*Proposal.* GCA proposes that the Commission use a method that may be thought of as a “bottom up” method to calculate avoided costs for use in evaluating presorting discounts. GCA argues that the Commission should estimate the costs avoided by converting the Base Group to 5-Digit mail and then compare the 5-Digit discount with that avoided cost. It appears to argue that the Commission should then add the appropriate increment of cost to each successive less finely sorted tier to calculate their avoided costs. It then would evaluate discounts by determining whether the difference between the discount offered for each less finely presorted tier and the discount for 5-Digit mail is no greater than the difference between the cost of each less finely sorted tier and 5-Digit mail. *Id.* at 32.

GCA supports its proposal by arguing that MAADC letters, which is the current initial reference point for what has become known as the “presort tree,” is poorly suited to that role. *Id.* at 31. It notes that the discount for MAADC has typically exceeded the costs that it avoids compared to the BMM benchmark. It also notes that MAADC mail has exhibited negative avoidable delivery costs relative to the BMM benchmark. *Id.*

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<sup>55</sup> For automation letters, the worksharing rate categories are MAADC, AADC, 3-Digit, and 5-Digit.

GCA contends that when mailers of First-Class letters decide to workshare, their likely goal is to presort their mail to the 5-Digit (or sometimes the 3-Digit) level. It asserts that MAADC mail is ordinarily just the residue of 5- or 3-Digit mailings. *Id.* at 32. It argues that because of its greater commercial importance, the most important cost avoidance/discount relationship to get right is the one offered for 5-Digit mail. *Id.* at 14-15.

*Parties' positions.* No participants comment on GCA's proposal to change the initial reference category for workshared First-Class letters.

*Commission analysis.* GCA's proposal to calculate avoided costs for the most finely sorted (5-Digit) tier and use it as the initial reference point for evaluating discounts is not unreasonable. The Commission has carefully considered GCA's arguments that MAADC letter discounts have exceeded avoided costs in the past, and that the volume for MAADC letters is relatively small. MAADC letter volumes are relatively small but, as Pitney Bowes points out, they are still substantial. Pitney Bowes Reply Comments at 20. Therefore, a passthrough for MAADC letters that observes the statutory cap remains important.

Whether and how section 3622(e) applies to MAADC rates has been under active consideration since Docket No. R2008-1. The Commission reserved action while those issues were being resolved. Commission findings in Docket No. RM2009-3 as well as in this case should resolve any continuing uncertainty of how section 3622(e) should be applied.

GCA's concerns about the relationship between the costs of MAADC and the BMM benchmark have been addressed in large measure by the Commission's recent approval of the major elements of Proposal 9 in Docket No. RM2011-5. See Order No 741. Prior to the adoption of these improvements, the use of an overstated NAMMA delivery cost as a proxy for the delivery cost of BMM caused the anomalous relationship between the costs of BMM and MAADC described by GCA. In support of Proposal 9, the Postal Service noted that it expected the modifications to correct anomalies for

those categories.<sup>56</sup> The revisions to the mail processing cost avoidance models from Proposal 9 adopted by the Commission improve the reliability of the mail flows for nonautomation presort letters. These improvements also result in more accurate estimates of DPS percentages, which in turn result in improved estimates of mail processing and delivery costs for each type of nonautomation presort letters, including NAMMA.<sup>57</sup>

Part of the potential appeal of GCA's proposal to begin the examination of discounts with the 5-Digit automation presort rate depends on the presumption that estimated cost of the 5-Digit automation presort category is more reliable than the estimated cost of the MAADC category. If it were feasible to implement GCA's complementary proposal to directly measure the cost of 5-Digit automation presort letters, this would strengthen the argument in favor of 5-Digit as a starting point. As explained above, however, it is not currently feasible to measure costs directly for the 5-Digit automation presort rate category. The costs of both 5-Digit and the current initial reference point (MAADC) within the automation "presort tree" are developed in the same mail processing and delivery cost models. There is no reason to assume that one is more or less reliable than the other.

#### D. Proposal of Pitney Bowes Inc.

*Proposal.* Modeled avoided costs and CRA attributable costs for the same processing activity are derived from different data reporting systems. For this and other reasons, they seldom match. The established letter cost model uses a single, average CRA adjustment factor to inflate or deflate the modeled cost for each price category to match its CRA cost. Pitney Bowes notes that the adjustment factor is much lower for

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<sup>56</sup> See Docket No. RM2011-5, Responses of the United States Postal Service to Questions 1-6 of Chairman's Information Request No. 2, February 25, 2011, question 1(a).

<sup>57</sup> Non-DPS letters must be put into walk sequence at the delivery unit by a carrier, while DPS letters do not incur this type of delivery cost. Therefore, the percentage of mail in a rate category that successfully goes through a DPS sort directly affects its delivery cost.

the incoming secondary sort than for the average of the other five sorting operations that are performed on presorted letters. It believes that using a single adjustment factor to tie modeled costs back to the actual CRA costs may understate the cost avoided by improving the presort level of First-Class Mail and Standard Mail Regular letters. Pitney Bowes Comments at 4-6. Thus, for presort First-Class letters and Standard Regular letters, Pitney Bowes proposes separate CRA adjustment factors for incoming secondary operations and for all other (non-incoming secondary) operations. *Id.*

Pitney Bowes compares the modeled and CRA letter sorting costs for the First-Class Mail and Standard Mail presort letter cost models. For both, it shows that the ratio of CRA-to-modeled costs is higher for non-incoming secondary sorting (sorting pieces by facility and 5-Digit ZIP Code), than for incoming secondary sorting (sorting pieces from 5-Digit ZIP Code to carrier route and delivery point sequence.) *Id.* at 6. Pitney Bowes contends that since the ratio of CRA-to-modeled costs is much higher for non-incoming secondary sorting than for incoming secondary sorting, the use of an aggregated adjustment factor appears to adjust non-incoming secondary costs too little, while adjusting incoming secondary costs too much. *Id.*

*Parties' positions.* GCA argues that this proposal is designed to increase the cost avoidance basis for discounts that Pitney Bowes receives for presorting mail to the 5-Digit level. GCA Reply Comments at 39. GCA also contends that a two-part CRA adjustment factor method does not fully distribute non-modeled CRA costs. *Id.* at 42. GCA asserts that a three-part adjustment is necessary to allocate the remaining non-modeled costs.

The Postal Service opposes the use of multiple CRA adjustments. The Postal Service explains that there are six processing operations (outgoing primary; outgoing secondary; incoming management mail program (MMP); incoming sectional center facility (SCF); incoming primary; and incoming secondary) and that Pitney Bowes provides no rationale for why the incoming secondary operation should be "singled out



for special treatment.” Postal Service Reply Comments at 11. The Postal Service also argues that in theory, model costs for all workshared categories could be compared to the CRA costs they are intended to represent, which is likely to produce at least six CRA adjustment factors for piece distribution operations. The Postal Service asserts that there is no reliable way to disaggregate costs to this degree. *Id.* at 13.

*Commission analysis.* The Commission finds that developing separate adjustment factors for each sorting operation has the potential to improve the accuracy of cost avoidance estimates. Nevertheless, as the Postal Service points out, Pitney Bowes does not adequately explain why the incoming secondary operation should be given unique treatment. The Commission is also concerned that data may not be sufficiently reliable to implement adjustment factors specific to individual operations. As the costs are disaggregated more finely, the accuracy and reliability of the adjustment factors—which are partially based on sampled data—may deteriorate.

## VII. PROPOSALS FOR NEW DISCOUNTS

In Docket No. RM2009-3, some participants advocated de-averaging rates for First-Class Mail by indicia. Others advocated a form of pre-barcoding discount that would recognize costs avoided by single-piece First-Class letters that are CASS-certified and bear an IMb. Order No. 536 deferred such proposals for consideration in this docket.

Stamps.com proposes that the Postal Service offer a workshare discount for what it calls Qualified PC Postage (QPCP). It would apply to single-piece First-Class letters with CASS-certified addresses and an IMb. It would target small to mid-size mailers who use meters.<sup>58</sup> Stamps.com Comments at 5.

Stamps.com estimates that currently, less than four percent of its customers would qualify for the QPCP discount, but it believes that a discount would prompt a large conversion, similar to the response to PC Postage discounts that were recently introduced for Express Mail and Priority Mail. It says that since those PC Postage discounts were instituted, its customers have increased their purchases of those discounted products by more than 50 percent. *Id.* Stamps.com also asserts that a QPCP discount would lead to increased use of advertising mail by small businesses. *Id.* at 6. It asserts that a discount for First-Class Mail prepared with the aid of PC Postage would be consistent with title 39 and could lead to a more efficient mailstream. *Id.* at 4.

Neopost USA proposes that the Postal Service offer a discount for what it calls the metered mail Initiative. It would apply to fully automation compatible single-piece First-Class letters with CASS certified addresses. Postage would be paid with an IBI. It recommends that it be made a stand-alone discount, not bundled with other existing

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<sup>58</sup> See Comments of Stamps.com; Reply Comments of Neopost USA. Since the 2008 Annual Compliance Review, Stamps.com has advocated such a discount. Stamps.com Comments at 1. Stamps.com's mailers include "ordinary consumers, small businesses, and some larger organizers." *Id.* at 4. Stamps.com asserts that most of the Postal Service's current workshare discounts are designed for large mailers. *Id.*

workshare discounts. It asserts that there is sufficient rationale for a permanent discount for the meter payment channel. Neopost USA Comments at 1. However, if necessary, it suggests that a volume threshold defined over a certain period of time could be added as an eligibility requirement. In the case of new customers, for example, it suggests that the discount could be based on the first year's mail volume. *Id.* at 2. Neopost asserts that the discount would meet the definition of workshare discounts under section 3622(e) because the qualifying mail would save the Postal Service certain processing, handling, and transportation costs. *Id.*

The Public Representative and Pitney Bowes both express support for discounts for small-to-medium-size businesses. The Public Representative recommends that the Postal Service phase in the discounts by starting with a passthrough well below 100 percent. PR Comments at 2. In addition, the Public Representative suggests that the discount could be initially set equal to the QBRM discount. Once the discount is operational, he says, the Postal Service would be able to develop a more appropriate rate as well as obtain more accurate cost avoidance calculations. *Id.* Pitney Bowes argues that the Postal Service could realize significant cost savings and increased contribution by encouraging customers to use more efficient distribution and payment evidencing channels. Pitney Bowes Reply Comments at 4.

The Postal Service criticizes these proposals as having been presented in partially developed form. It asserts that the record supporting QPCP is thin and the supporting rationale is insufficient. *Id.* at 15. It argues that the proposals do not address the cost basis for discounts with enough specificity. It asserts that there is no reason to believe that the volume of mail would increase for IBI letters or PC Postage letters if a discount were implemented. Postal Service Reply Comments at 9. The Postal Service further states that if the volume remains low, the criteria that analyses of avoided costs should be stable from year to year is not likely to be satisfied. *Id.* It also

describes several downsides to the Public Representative's suggestion that QBRM could be used as the initial basis for the QPCP discount.<sup>59</sup>

*Commission analysis.* Stamps.com and Neopost suggest that new discount rate categories be established. While these discounts would be permissible under the PAEA, to this point, the Postal Service has shown no inclination to implement them, and the PAEA accords the Postal Service the pricing flexibility to offer such discounts or not, as it sees fit.

The Commission recommends that the Postal Service work with Stamps.com, Neopost USA, and other postage system providers to explore the potential benefits of offering an incentive to small-to-medium-size business users of First-Class letter mail. The proposals would extend access to discounts to the small business segment and could provide an effective incentive to this portion of the First-Class letter mail market. A discount for this type of mail would be consistent with several important objectives and factors of the PAEA, including sections 3622(b)(1) (maximize incentives to reduce costs and increase efficiency), 3622(c)(5) (take into account the degree of preparation of mail performed by the mailer and its effect upon reduction of Postal Service costs), and 3622(c)(13) (take into account the value of promoting IMb).

The Postal Service's concerns about estimating the avoided costs associated with this type of mail do not appear to present an insurmountable hurdle. Section 3622(e) provides an exception for new workshare initiatives, which should allow sufficient time for data and methodologies to be refined. Furthermore, a cost avoidance estimate could potentially be based on proxies or engineering models that would be stable for even low volume categories of mail. Nonetheless, while discounts of the kind

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<sup>59</sup> The Postal Service asserts that the Public Representative does not discuss whether the handwritten benchmark for QBRM should be the same benchmark for QPCP. In addition, the Postal Service contends that the Commission previously stated that it has concerns with the QBRM cost avoidance methodology. Furthermore, the Postal Service states that no proponents of the discount addressed revenue protection issues. *Id.* at 13-14.

proposed appear to promote the policies of the PAEA, whether to offer them or not is within the Postal Service's discretion.<sup>60</sup>

Shoshana M. Grove  
Secretary

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<sup>60</sup> The PAEA provided a mechanism for the Postal Service, the Commission, or users of the mails, to initiate action leading to new or modified products. See 39 U.S.C. 3642(a). However, in the first instance, establishing prices for new products generally is subject to the Postal Service's discretion.

## Appendix

## Appendix: Examples of Cost and Mail Flow Models for First-Class Mail Letters

Source: Docket No. ACR2011, Library Reference PRC-ACR2011-LR-2 – FY 2011 First-Class Mail.

(1) First-Class Automation Three-Digit Presorted Letters -- Cost Model

[illegible]

## (2) First-Class Automation Three-Digit Presorted Letters – Mail Flow Model

